

By email:
regfinance@ofgem.gov.uk

11 November 2024

Ref Ring fence review: energy networks call for input

Dear Ofgem,

We welcome the opportunity to contribute to your Call For Input (CFI) on energy networks' ring fence arrangements. In preparing our response we have worked closely with other network companies through the ENA. The ENA has provided a response¹ on behalf of all members setting out our concerns in detail which we fully support.

We agree with Ofgem that ensuring a financially resilient energy sector is in customers' interests. The financial resilience of networks cannot be considered in isolation to the wider benefits that networks provide to customers. The key benefits associated with safe and reliable networks, the facilitation of the transition to net zero and supporting wider economic growth (through the creation of jobs and provision of the infrastructure necessary to connect the homes, low carbon technologies and industries of the future) can only be achieved if networks are financially resilient and able to source sufficient investment.

Since privatisation Ofgem has frequently and robustly reviewed and updated the ring fence arrangements that apply to energy networks. Arrangements implemented by other regulators and for other sectors have not been as robust which may be demonstrated by the well-publicised financial difficulties of some companies in the water sector for example. This suggests that Ofgem's established arrangements have been successful in respect of energy networks, with no documented failures within the sector despite recent economic and energy market challenges.

Ofgem already has a comprehensive suite of obligations and mechanisms in place regarding financial resilience, dividends and their reporting to which SPEN take their obligations very seriously. It is appropriate that Ofgem periodically reviews the ring fence arrangements in light of experience of their operation, market developments, and regulatory best practice which we believe has recently been undertaken as part of the Sector Specific Methodology Consultation (SSMC) and subsequent Sector Specific Methodology Decision (SSMD) for RIIO-3.

Ofgem also has appropriate powers to intervene should it have evidence that intervention is required. We note that Ofgem has not shared with energy networks the evidence of

¹ ENA Response – Ofgem Ring fence Review 08/11/24

potential customer harm that it says lead it to conclude that a “do nothing” approach could be inappropriate. We are surprised at Ofgem’s conclusion and would welcome discussions to understand this further.

We believe that there is no evidence to justify introducing any of Ofgem’s suggested “higher intervention approaches”. These would inappropriately increase regulatory burden, increase the cost of capital, negatively impact financeability or investability or, in some cases, might even precipitate financial distress. It would be counter to the principles of Better Regulation to implement such disproportionate or untargeted measures.

It is our view that if Ofgem has concerns that were not addressed in its recent RIIO-3 SSMD, it should undertake a detailed review. This review should analyse the impact of available options in detail and, if demonstrated to be necessary, propose a proportionate and targeted approach to address any concerns identified. Ofgem should not enter such a review with a pre-conceived assumption that changes to requirements must result from such a review. We would be willing to support Ofgem to undertake such a review.

This review should comprise:

- Sharing with networks (confidentially if necessary) the evidence that Ofgem has that leads it to conclude that “do nothing” is inappropriate. This would enable networks to support Ofgem in considering whether they arise due to shortcomings in the current framework or other factors that should be addressed differently;
- Detailed consideration by Ofgem of the substantial information that networks already report to Ofgem regarding financial resilience and dividends, including Ofgem’s own processes for routinely scrutinizing such information;
- Providing feedback to all networks on any concerns that Ofgem might find regarding either the completeness or quality of the information reported to Ofgem or with the network’s compliance with existing ring fence obligations or the resilience of the network’s financial structure more generally;
- Engaging with investors to understand current financial structures and any concerns that investors would have if ring fence arrangements were to be further modified; and
- Based on the above, analysing findings to establish whether there is any evidence of shortcomings in the current arrangements. It will be important that the outcome of the review differentiates between any inadequacies in networks’ compliance with or implementation of current obligations and any inadequacies in the requirements themselves.

Based on the evidence that is obtained from this review, Ofgem could:

- Conclude that no change to the current arrangements is required;
- Use its existing powers to intervene in a network’s activities should it have evidence that intervention is required;
- Clarify the existing obligations, for example by issuing improved reporting guidance or amending the wording in the licence; or
- If evidence is found, consider targeted changes to the current ring fence arrangements.

It is our view that financial resilience cannot be considered in isolation to financeability and investability. Any detailed review must take account of the interaction with the price

control policies that the ring fence arrangements are designed to co-exist with. A number of Ofgem's proposed RIIO-3 policies are more likely to precipitate financial distress amongst energy networks than any perceived shortcoming in the ring fence arrangements.

We look forward to discussing this further with you.

Yours sincerely,



David Holland
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